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JAPAN'S MULTINATIONAL CORPORATIONS AT A TURNING POINT

SUMMARY

As Japan's involvement in the international economy has grown, its companies continuously have altered their mode of operation. Among other changes firms have established a presence on the ground in an array of countries that are bewilderingly different from Japan. The exponential growth in the 1980s of Japanese direct investment abroad raises questions about the internationalization of the corporate culture.

Japan's corporate foreign direct investment to date arguably has had a different relation to both the host and the home nation than that of other nations' companies. In general, the head office has exercised tighter control. While the mass media in the United States generally give the impression that the operations of Japanese-affiliated companies in this country have been smashing successes from the firms' — if not society's — viewpoint, such conclusions appear to be premature. The jury still is out as to whether Japanese firms can overcome the inherent disadvantages of multinational companies and be as successful as their counterparts in other industrial countries.

The Road to Internationalization

Many analysts divide the process of corporate internationalization into phases. In the first phase firms begin overseas sales of the products they produce at home. In this stage, which may involve exports and imports exclusively, manufacturers are forced to pay attention to the world beyond their boundaries for the first time. Only later do the firms venture offshore to build facilities that supply foreign markets from abroad; in this way they replace exports, at least to the degree that exports otherwise would reach higher levels. Usually at this stage — and not earlier — companies are regarded as multinationals. In the final stage the overseas facility even may be a significant source of imports for the home country as well as a major supplier of the local market.

In this simple description the establishment of an export market becomes a prerequisite for direct investment abroad. Firms generally need the assurance that their product will sell abroad before

they commit themselves to a substantial investment in overseas facilities. An important exception are service industries. In such sectors as banking and lodging exports are virtually impossible. If Mitsubishi Bank, Ltd., for example, wants to sell its services to Americans or to expatriate Japanese here, it cannot avoid setting up shop on this side of the ocean.

Exporters, however, do not necessarily become multinational firms.[1] In fact, becoming a multinational would appear as unlikely as the ungainly bumble bee learning to fly; theoretically both acts appear to be impossible. To the extent that a company is good at something, its greatest advantage is likely to be on its home turf, where language and customs are most familiar. Success may depend on an advantage (low-cost or highly skilled labor) that is available only at home. This factor suggests that exports are the more logical course. Conversely, if a foreign location is an imperative, as in banking, local firms typically have an advantage over the would-be foreign investor. The foreign firm well may find that its advantage is location-specific so that it will have disadvantages — rather than advantages — compared to local firms should it establish operations abroad. Even if its advantage can be exploited equally everywhere, in some cases the foreign firm may find it more profitable to make that advantage available — for a franchise or licensing fee — to local firms that do not have the burden of unfamiliar language, culture and operating conditions. If for some reason such expertise or cost advantage is not marketable through such agreements, the would-be investor faces a worry that potential rivals could obtain the same advantage. If impressed early on that maintaining an edge over local companies would be futile, a wise firm logically would decide against the investment.

In short, experts can give would-be foreign investors and bumble bees many reasons why they should be cautious about spreading their wings. But bumble bees fly, and firms invest abroad. In both cases they have advantages that defy conventional wisdom. Firms invest abroad because exports may be impossible or difficult for economic or political reasons and they find that they have some pluses that overcome the minuses of an inherently alien environment.

Growth of Japanese Foreign Direct Investment

For much of the postwar era Japanese firms did not feel as if they could overcome the inherent disadvantages of overseas investment. In addition, until at least the 1960s, they faced government-imposed restrictions on their ability to invest overseas.[2] If they were good at producing something (cameras and consumer electronics products, for example), the product entered international commerce as an export. Whenever Japanese suppliers did not have a comparative advantage or Japan appeared an unlikely or undesirable place in which to produce a product, imports typically filled the bill (wheat and crude oil, to name two), with domestic firms — other than the trading companies that facilitated imports and exports — having little involvement outside Japan. (However, of what little direct investment abroad did occur during this period more than a third was natural resource-based.) If the product or service could be produced or provided only on location, the Japanese presence abroad was minimal (banking, insurance, retailing).

By the early 1980s, if not earlier, this cozy division of labor began changing. As trade tensions increased in Japan's export markets, Japanese firms faced the prospect of losing market share if they did not establish a means of surmounting rising protectionist barriers, such as the 1981 voluntary restraint agreement on Japan's U.S.-bound car exports. In addition, some Japanese analysts have argued that the changing composition of Japanese foreign sales dictated a presence closer to the final consumer, even when protectionist pressures were absent.

Different factors motivated investment in the service sector. Rising levels of Japanese exports and of Japanese tourists abroad created new demands for service industries, such as Japanese-owned

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financial institutions and lodging companies. These were perceived rightly or wrongly as having advantages that local companies could not provide for Japanese clients. Hence, Nomura Securities Co., Ltd. and Nikko Hotels followed in the footsteps of Merrill Lynch & Co. and Hilton Hotels in establishing a worldwide presence. Finally, some financial institutions may have had new incentives to go abroad, either to avoid restrictions on their activity in Japan or to try out new services they hoped to introduce in Japan once restrictions were lifted. (For this argument with respect to banks, see *JEI Report* No. 22A, June 8, 1990; for a similar argument concerning insurance companies, see *JEI Report* No. 31A, August 12, 1988.)

At the same time that the benefits of foreign investment were increasing, the costs were declining. As the yen increased in value after 1985 the cost advantage of producing in Japan dropped sharply or became a disadvantage — even compared to relatively high-cost manufacturing nations such as the United States. A stronger yen meant that any given dollar cost corresponded to a lower yen cost. Although dollar-denominated manufacturing costs in Japan had increased only slightly betweeen 1973 and 1985, they shot up more than 40 percent between 1985 and 1988 alone. By 1990 Japanese manufacturing costs on average were 10 percent above those of the United States despite a relatively weak yen that year.[3] By mid-February 1992 the yen had appreciated more than 10 percent from its 1990 average level, suggesting that the U.S. cost advantage may have widened despite higher inflation in this country. (For details of Japanese pricing decisions in the context of the higher yen, see *JEI Report* No. 43A, November 15, 1991.)

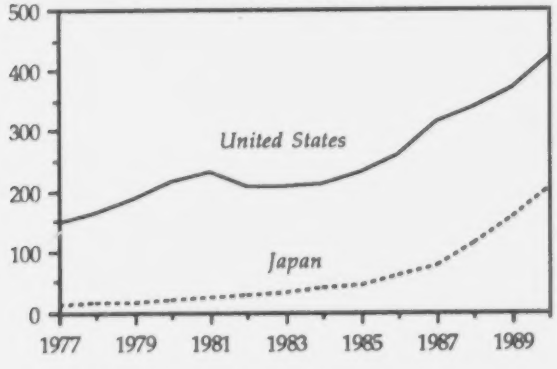
Figure 1 shows the growth of Japan's dollar-denominated exports and the stock of Japanese direct investment abroad. (Direct investment abroad is defined as loans, equity positions or business-related real estate transactions involving overseas branches, subsidiaries or associated companies in which the Japanese investor has at least 10 percent equity.) Foreign direct investment grew consistently faster than exports throughout the period, more than tripling between 1977 and 1984 against roughly a doubling of exports. Between 1984 and 1990 the gap in growth rates appeared to widen even more as the stock of direct investment abroad soared by 431.2 percent, while exports increased 66.1 percent. (In the latter period dollar depreciation substantially inflated both figures.) Given that manufacturing maintained a roughly equal share of the capital stock, plus the assumption that production increases roughly correspond to capacity increases, Figure 1 suggests that overseas production has become far more important relative to exports than just a few years ago. The numbers, however, do not provide guidance as to the relative current status of each means of supplying foreign markets.

Figure 1: **Japan's Exports and Stock of Direct Investment Abroad 1977-1990**

Source: Bank of Japan

Figure 2 shows Japanese direct investment abroad relative to that of the United States. Despite the recent rapid growth in Japanese direct investment abroad, the U.S. level still was more than twice as high in 1990, the latest year for which complete data are available. Both figures are based on historical cost, or the cost of acquiring the overseas property, regardless of current value. Recent Department of Commerce estimates suggest that the market cost of U.S. direct investment abroad was twice historical cost in 1988. For this reason, the U.S. figure probably is understated relative to that of Japan since American investment is older on average. Based on estimates of the Japan External Trade Organization (in which the same deficiencies occur), U.S. direct investment abroad represented 29.6 percent of the world total in 1989, the most recent year for which comparable data are available. Runners-up Great Britain and Japan accounted for 15.2 percent and 12.2 percent, respectively.

Figure 2: **Stock of U.S. and Japanese Direct Investment Abroad**
(billions of dollars)



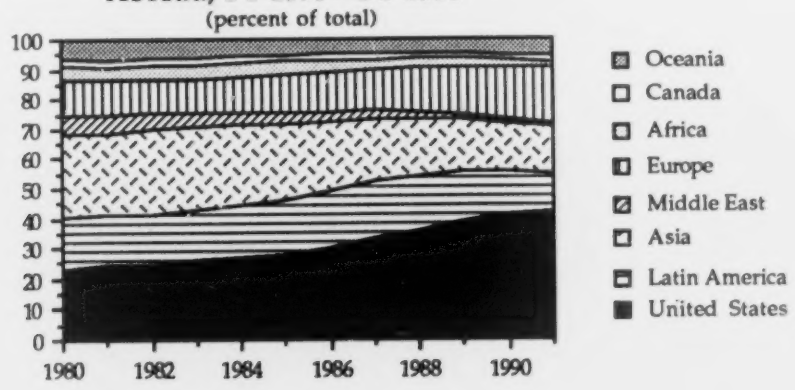
Source: Department of Commerce and Bank of Japan

Figures 3 and 4 show how the distribution of Japanese direct investment abroad has changed over time. In contrast to Figures 1 and 2, which use Bank of Japan data, Figures 3 and 4 use Ministry of Finance data.[4] Since the 1970s the proportion of Japan's direct investment abroad going to the United States and Europe has risen substantially, while the proportion going to Asia and Latin America has fallen. For example, the United States represented 21 percent of the outstanding level of Japanese foreign direct investment on March 31, 1977; on the same date in 1987 this level had risen to 30.2 percent, and in 1991, the most recent year for which data are available, to 42 percent.

These figures argue against the proposition sometimes heard that Japanese firms increasingly have emphasized the development of an integrated economy within Asia at the expense of the United States. Japan's economy may be in the process of becoming more integrated with those abroad generally; if so, the process probably has proceeded further in North America than elsewhere. For example, in 1987 overall Japanese direct investment in this country was 18 times as large as that in Thailand. By 1991, despite the widely publicized growth in Japanese direct investment in that Asian country in the intervening years, the United States had 29.5 times as much Japanese direct investment as did Thailand.

The pattern by industry shows that nonmanufacturing industries typically have garnered slightly more than 70 percent of all direct investment flows, reaching 71.8 percent of the total stock as of March 31, 1991. Even within manufacturing variation has been comparatively modest. In FY 1981 the transportation equipment industry accounted for 2.7 percent of total outstanding direct investment

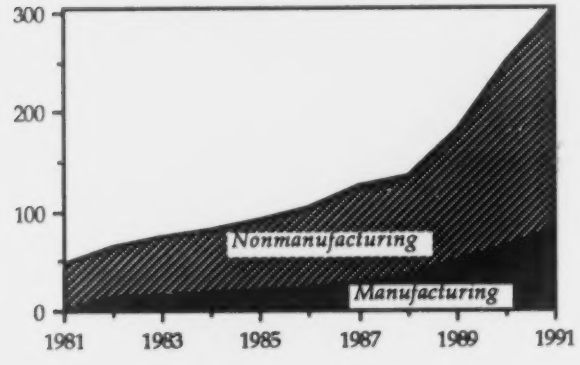
Figure 3: **Geographic Distribution of Japanese Direct Investment Abroad, FY 1979—FY 1990**



Note: Data compiled March 31 of each year.
Source: Ministry of Finance

Figure 4: **Stock of Direct Investment Abroad by Industry, FY 1980—FY 1990**

(billions of dollars)



Note: March 31 of each year.
Source: Ministry of Finance

abroad, rising to 4 percent in FY 1986 and dropping to 3.5 percent in FY 1991. Obviously, in some subcategories in particular host nations, the variation has been greater. In 1980 no Japanese-affiliated automotive assembly plants existed in the United States; such plants employed thousands of workers by 1991.

Table 1 shows the distribution of Japanese direct investment in the United States by industry based on Department of Commerce data, which correspond more closely to BOJ than to MOF data in terms of aggregate totals. (Since the criteria for industry classification differ from that employed in Figure 3, comparisons between Figure 3 and Table 1 are inappropriate.) Table 1 points to a sharp rise in the share of outstanding Japanese investment accounted for by manufacturing during the second half of the 1980s. The share of wholesale trade, in contrast, declined over that time frame despite some manufacturing activity being classified as "wholesale trade" on the basis of the historical activity of firms that had begun manufacturing here.

Table 1: **Japan's Foreign Direct Investment Position in the United States, Yearend 1986-90**

(in millions of dollars, historical cost basis)

	1986	1987	1988	1989	1990
Total	$26,824	$34,421	$51,126	$67,319	$83,498
Petroleum	34	-56	-64	-35	-38
Manufacturing	3,578	4,970	11,065	13,978	15,169
Food Products	158	281	393	641	662
Chemicals	279	932	1,677	2,272	3,918
Metals	471	602	1,293	2,248	2,090
Machinery	1,052	1,686	2,930	4,150	4,210
Other	1,618	1,469	4,772	4,667	4,289
Wholesale Trade	13,687	15,927	18,462	21,972	27,645
Retail Trade	290	373	411	511	627
Banking	2,704	3,655	4,367	4,959	6,025
Finance	2,087	2,994	5,666	9,407	10,402
Insurance	*	188	266	355	477
Real Estate	2,941	4,386	8,190	11,370	15,860
Other	1,306	1,984	2,763	4,802	7,331

*Suppressed to avoid disclosure of data on individual companies.

Source: Department of Commerce

Are Japanese Companies Becoming More International?

Kokusai-ka is a Japanese term that has been in use for generations. It means "internationalization" and has been used both descriptively and prescriptively to describe changes in Japanese individuals, corporations and government. Exactly what *kokusai-ka* means in specific instances often is elusive, however. Surely, Japanese companies are more "international" now than they were 20 years ago if one considers only the extent to which they are known overseas. As suggested above, they also increasingly have become employers abroad; this new role brings with it increased concern with laws and customs of other countries. Internationalization may be defined alternatively as the production of output abroad or as the use of foreign inputs. These two concepts lead to somewhat different conclusions as to how international Japanese companies have become.

Internationalization of Output - Table 2 shows that internationalization in the sense of firms producing a high share of their output overseas is an area where Japanese companies have come a long way but by no means have caught up with their American and German counterparts. Table 2 also suggests that Japanese direct investment abroad is more likely in industries in which Japan is most competitive, especially if one assumes that Japan is more competitive in products using skilled workers than those that do not. For example, among a cross section of manufacturers surveyed in 1989 by the Ministry of International Trade and Industry, 5.7 percent of combined manufacturing output occurred outside Japan, but at 15.9 percent the figure was far higher for makers of transportation equipment, such as cars, and for electrical machinery manufacturers at 11 percent than for makers of textiles (1.3 percent) or food products (1.3 percent).[5] In this respect, Japan is similar to the United States. A recent MITI study found that both the United States and Japan tended to have higher levels of direct investment abroad in those industries in which they were highly competitive than in those in which they were not.[6]

Table 2: **International Comparison of Overseas Production, 1979-90**

(manufacturing output at overseas affiliates as percentage of total production)

			Japan		
	United States	West Germany*	Total	Textiles	Transport Equipment
1979	19.5%**	9.2%	1.6%	n.a.	n.a.
1980	n.a.	10.1	2.9	4.0%	2.2%
1982	21.1	12.1	3.2	2.7	6.1
1984	18.1	14.2	4.3	4.7	6.4
1985	18.1	13.7	3.0	2.7	5.6
			(3.5)	(3.5)	(6.4)
1986	21.0	10.3	(3.2)	(3.4)	(4.8)
1987	21.0	n.a.	(4.0)	(3.1)	(9.3)
1988	24.9	n.a.	(4.9)	(4.2)	(9.4)
1989	n.a.	11.5	(5.7)	(1.3)	(15.9)
1990	n.a.	n.a.	(6.3)	n.a.	n.a.

*Excludes production in other European Community nations.
**1977 data.

Notes: The data for the United States and West Germany are on a calendar-year basis, while the figures for Japan are based on the fiscal year.
The figures in parenthesis include production by subsidiaries of subsidiaries.

Sources: Ministry of International Trade and Industry, "Kaigai Jigyo Katsudo Doko Chosa" (April 1989), and *Tsusho Hakusho* (Tokyo, Japan: Okura-sho, 1991), p. 212; Economic Planning Agency, *Kaizai Hakusho* (Tokyo, Japan: Okura-sho, 1991), p. 494.

In addition, investment seems most likely in those countries that are Japan's rivals in producing goods and services using high-wage labor. For example, Japanese direct investment has been especially large in North America in recent years. The MITI survey suggested that the main reason for such activity (cited by 60 percent of all respondents, who were able to give multiple responses) was to "expand sales in the world market" rather than cost-related reasons (cited by fewer than 30 percent). Even among those who had invested in the relatively low-wage countries belonging to the Association of Southeast Asian Nations, costs were cited in only 70 percent of all cases.[7] This suggests that Japanese firms' investment decisions are not necessarily motivated by low wages abroad; in some cases wages appear to be virtually irrelevant.

To the extent that Japanese direct investment abroad primarily is in response to protectionism or political pressure rather than cost considerations, the internationalization of Japanese companies probably is much less than it otherwise might be. As Gary Saxonhouse of the University of Michigan has argued in congressional testimony concerning foreign direct investment in the United States:

> ... Restraints on Japanese exports too often forces Japan to produce abroad what it could perfectly well produce at home. Therefore, it's hardly surprising that such Japanese-owned factories abroad import as many components as they possibly can from Japan. This is not the result of any cultural peculiarity. Rather these components are the basis of their competitiveness. It is a sensible economic response to a difficult situation created by foreign protectionism.[8]

Not surprisingly, relatively little of what Japanese companies make overseas finds its way back to Japan, according to MITI studies. In 1989 only 7.9 percent of the production of Japanese-owned manufacturing plants overseas was exported to Japan; instead, over 80 percent of the output was sold in the host nation. Asia was somwhat different in this regard; roughly 60 percent of the manufacturing output was sold in the nation in which it was produced, less than 20 percent shipped to Japan and about 20 percent sold in third markets.[9]

In contrast, Commerce Department figures show that 12.9 percent of the worldwide output of foreign manufacturing subsidiaries of U.S. parents was shipped to the United States in 1988. Roughly 60 percent was marketed in the host nation. Exports to the United States from Asian-based U.S. subsidiaries, however, were higher at 23.2 percent, while 43.4 percent remained in the country of production and 33.5 percent was sold elsewhere. Hence, while U.S. firms, like Japanese companies, sell large amounts of their output in the host nation, American companies are more likely than their Japanese counterparts to export from the host nation, either to this country or elsewhere.

In short, Japanese firms have further to go to obtain international corporate citizenship if by that term one means having facilities around the world that serve international markets. Canadians no longer are surprised to find in their local stores products made in Italy by American-headquartered companies, for example; they are more likely to find competitive Japanese products and services either supplied from Japan or North America.

Internationalization of Inputs - Japanese companies have been accused of exceeding the excess baggage allowance for overseas investors: even though they may leave home, they bring a lot of their home along with them, according to this argument. In particular, American trade officials and others have argued that Japanese firms operating abroad typically buy a great deal from Japanese suppliers, especially capital goods. In a related vein, they also point to Japanese multinationals' staffing, with its disproportionate numbers of Japanese nationals who are given little authority to act independently of the home office.

As suggested above, such actions may make perfect economic sense. Many analysts continue to see them, however, as barriers to foreign sales. A study by Mordechai E. Kreinin of Michigan State University lends support to their argument.[10] He picked the apparently neutral ground of Australia to contrast the behavior of Japanese, American and European subsidiaries with respect to the question of how closely tied the affiliates were to home offices and to home-country suppliers. His results appeared to confirm the arguments of those analysts who accuse Japanese firms of being parochial. Mr. Kreinin found, for example, that Japanese companies were far more likely to buy capital equipment from Japan without putting the order up for competitive bidding than were American and European companies, which differed relatively little from each other in this regard. Not surprisingly, Japanese companies ended up with Japanese equipment, while American and European companies appeared to buy from a large cross section of nations. European and American companies, moreover, were likely to be run by an Australian; Japanese companies typically were headed by a Japanese.

MITI data lend credence to Mr. Kreinin's arguments. In one undated study of manufacturing firms published in 1991 MITI compared Japanese firms abroad with foreign firms in Japan. (For details of foreign direct investment in Japan, see *JEI Report* No. 35A, September 20, 1991.) On each of 11 questions involving local control, foreign concerns in Japan were given more automony by their parents than their Japanese counterparts abroad. On some questions, such as marketing strategies, the differences were narrow, with both groups of subsidiaries being given wide latitude. On some long-term questions, however, Japanese companies were kept on a much shorter leash; almost 30 percent of the surveyed foreign firms could decide on their own to raise additional capital; fewer than 10 percent of Japanese firms could.[11]

The Kreinin study and the MITI survey suffer from some similar problems. The Japanese and the foreign firms in the Kreinin study were very different from each other in many ways having nothing to do with the parent's nationality. For example, they operated in different industries; in the

Kreinin study automotive companies and parts suppliers represented half the total Japanese sample while forming 12 percent of the European and American companies' representation. Otherwise, there was no industry overlap at all in the Kreinin study between the Japanese sample of 20 companies and the sample of 22 American firms and 20 European corporations. For example, seven of the U.S. and European companies were pharmaceutical or chemical companies; none of the Japanese companies were. Conceivably, differences by industry with respect to procurement and management could overwhelm whatever differences are attributable to the home country of the parent; Mr. Kreinin does not address this possibility.

In both the Kreinin and the MITI studies the non-Japanese firms had been operating abroad far longer than their Japanese counterparts, suggesting the possibility that Japanese companies will become more "naturalized" over time. Indeed, both Mr. Kreinin and MITI analysts found evidence that Japanese behavior is moving in that direction. A separate 1991 MITI study documented this trend. Its sample of Japanese investors worldwide showed that local procurement rose from 40.1 percent of all procurement in fiscal 1986 (April 1, 1986-March 31, 1987) to 47.9 percent in FY 1990. Similarly, imports from countries other than Japan by Japanese overseas affiliates rose from 6.9 percent to 7.3 percent of the total, implying that procurement from Japan dropped from 53 percent to 44.8 percent over four years. (Note that, since these figures do not include labor or capital costs, local content figures, which are inclusive of such items, would be far higher.)[12]

Some reseachers find evidence supporting Mr. Saxonhouse's statement implying that Japanese-owned subsidiaries operating in the United States also import relatively large proportions of inputs. The best known of these efforts is an Institute for International Economics study by Paul Krugman of the Massachusetts Institute of Technology and Edward M. Graham of IIE. They found that, compared to their mostly European counterparts, Japanese companies imported three times as much per worker from their home country, although the researchers were careful to note that their finding was tentative and may have reflected other factors, such as the relatively recent vintage of most Japanese investment.

Messrs. Graham and Krugman generally painted Japanese direct investment in this country in a favorable light from the American perspective. Their results support the impression from the production figures cited above that Japanese companies tend to concentrate their U.S. manufacturing investment in industries making products that use expensive labor. Not coincidentally, these same industries are highly productive from the host nation's standpoint. The two economists observed that research expenditures per worker at Japanese-owned firms in this country were higher than the U.S. manufacturing average (although lower than that of other foreign direct investors); salaries also were better than either the U.S. manufacturing average or those given by other foreign investors on average, and exports were above the average of other foreign investors. (No data were given for the exports of purely domestic firms.)[13]

Will Internationalization Be Successful?

Foreign direct investment — one of the principal components of a truly international company — has to overcome several inevitable obstacles to be successful. For example, Japanese companies investing in the United States have to possess or develop the skills to manage a heterogeneous work force — the most educated of whom probably have a better education than their Japanese managers, while the least educated of whom may be functionally illiterate, a condition almost unknown in Japan. Some of their American workers may speak a variant of English that even Japanese managers fluent in the language may find baffling. A large percentage of the pool of potential professional workers may be female, in considerable contrast to Japan. In addition to these personnel questions, Japanese managers have to deal with problems associated with communicating over long distances with the home office.

Despite these obstacles Japanese direct investment here typically is described in the American media as a smashing success. That conclusion is based largely on the experience of rising production

levels and acceptance of the output of Japanese automotive companies. Yet, estimates based on Commerce Department data imply that the value of cars and trucks produced here as a percentage of the U.S. sales of Japanese affiliates in 1988 was 6 percent even after including manufacturing activities that typically have been misclassified under "wholesaling."[14] This statistic suggests that Japanese motor vehicle production in this country, while important, is not a sufficient basis to draw general conclusions about the success of Japanese-owned manufacturing facilities in the United States. In the long run Japanese automotive and other companies will maintain or expand only profitable operations; otherwise, competitive conditions dictate that capital be redeployed. (As if to demonstrate this point and to suggest that even Japanese automakers occasionally retreat, Nissan Motor Co., Ltd. announced in February that it was closing its Australian assembly operation, presumably one of the 20 Japanese firms studied by Mr. Kreinin.)

This argument suggests that profitability rather than a market presence is a key criterion of success for Japanese foreign direct investors, at least in the long run. According to a MITI study, Japanese-affiliated manufacturing firms in North America showed negative changes in retained earnings (dividend payments and similar charges exceeded profits) in FY 1989; this suggests that profits probably were negative since dividends and other payments typically are small. Additions to retained earnings were positive in Asia and Europe, however.[15] Profits on all direct investments worldwide among the sample companies showed an up-and-down pattern during the 1980s, although they rose from FY 1980's level of ¥618 billion ($2.9 billion at ¥213.1=$1.00, the relevant exchange rate for that period) to ¥950 billion ($6.7 billion at ¥141.28=$1.00, the average exchange rate for the April 1990-March 1991 period) in FY 1990.[16] During the same time overseas assets increased in value 7.5 times, suggesting that profit rates plummeted. However, these results also reflect, in part, high start-up costs and the strong yen, which translated the dollar returns into fewer yen, other factors equal. In short, at a minimum, the profitability data suggest that direct investment abroad has not yet achieved a primary goal and is not currently on a clear trend to do so.

Conclusion

Corporate Japan's uneven success to date in earning profits from its overseas investments may be of only limited relevance to the future prospects for direct investment abroad. As Japanese companies' hiring practices become diversified in response to pressures to "go native," they may or may not find equal success. Japanese financial services firms, which employ an overwhelmingly white-collar work force, appear to have struggled compared to their manufacturing brethren, who hire more blue-collar workers. Even Japanese manufacturers, though, seem to have trouble attracting and keeping middle management in their operations abroad.[17] For these reasons the jury still is out as to whether Japanese direct investment abroad will be successful in the 1990s.

On the broader question of whether Japanese firms are becoming internationalized, the answer is that they have made substantial progress, although they fall short of what policymakers in host countries would like. Whether their tendency to look toward Japan for people and products will fade over time and whether Japanese firms will be able to prosper in a multinational environment are among the key questions facing Japanese companies in the 1990s.

For further information, contact **Douglas Ostrom**.

Dan Levison provided research assistance.

Notes

[1]For a brief discussion of the theoretical underpinnings of multinational firms and direct investment abroad, see Edward M. Graham and Paul Krugman, *Foreign Direct Investment in the United*

States (2nd ed; Washington, D.C.: Institute for International Economics, 1991), pp. 35-38 and pp. 177-179) and the references cited therein. The best-known source on this subject probably is Richard E. Caves, *Multinational Enterprise and Economic Analysis* (Cambridge, England: Cambridge University Press, 1982). See also A.M. Rugman, "Internationalization as a General Theory of Foreign Direct Investment: A Reappraisal of the Literature," *Weltwirtschaftliches Archiv*, Bd. CXIV, No. 198, 1980, pp. 365-379.

[2]For a discussion of direct investment abroad during this period, see Lawrence Krause and Sueo Sekiguchi, "Japan and the World Economy" in Hugh Patrick and Henry Rosovsky (eds.), *Asia's New Giant* (Washington, D.C.: Brookings Institution, 1976), pp. 447-450. For 12 articles on Japanese investment in the United States in recent years, see Kozo Yamamura (ed.), *Japanese Investment in the United States: Should We Be Concerned?* (Seattle, Washington: Society for Japanese Studies, 1989). Some of the articles in this volume focus primarily on portfolio investment, in which Japanese companies are assumed to play a more passive role than with direct investment.

[3]For details, see Donald J. Daly, "Exchange Rates and Trade Flows," *Business and the Contemporary World* (special issue), 1992 (forthcoming).

[4]The Ministry of Finance data have serious flaws in many respects. The figures are based on the announced intentions of Japanese firms — "approvals," but no adjustment is made if firms do not follow through on their plans. Nor is any adjustment made in later periods for investments that decrease (or increase) in value, which are sold to Japanese or non-Japanese firms, or which mysteriously disappear. In contrast to the MOF data, the BOJ numbers contain several important adjustments that make the figures smaller in aggregate. However, BOJ data are not available by region or industry.

[5]Economic Planning Agency, *Keizai Hakusho* (Tokyo, Japan: Okura-sho, 1991), pp. 308, 494.

[6]Ministry of International Trade and Industry, *Tsusho Hakusho* (Tokyo, Japan: Okura-sho, 1991), p. 214.

[7]*Ibid.*

[8]Written statement of Gary R. Saxonhouse before the Joint Economic Committee, December 17, 1991, p. 6.

[9]MITI, *op. cit.*, p. 223.

[10]Mordechai E. Kreinin, "How Closed is Japan's Market? Additional Evidence," *The World Economy*, XI, No. 4, pp. 42-52. For a critique, see Gary R. Saxonhouse, "How Open is Japan? Comment" in Paul Krugman (ed.), *Trade with Japan: Has the Door Opened Wider?* (Chicago, Illinois: University of Chicago Press, 1991), pp. 41-42.

[11]MITI, *op.cit.*, p. 225. For results of a related study, see EPA, *op. cit.*, pp. 352 and 504.

[12]Ministry of International Trade and Industry, "Kaigai Jigyo Katsudo Doko Chosa no Gaiyo" (Tokyo, Japan: December 1991), p. 16.

[13]Edward M. Graham and Paul R. Krugman, *Foreign Direct Investment in the United States* (Washington, D.C.: Institute for International Economics, 1991), pp. 74-80. Additional analysis of the role of Japanese and other foreign direct investors in the U.S. economy is found in Department of Commerce, *Foreign Direct Investment in the United States* (Washington, D.C.: Government Printing Office, 1991). The survey includes case studies of the electronics, automotive, steel, chemicals and banking industries.

[14]The figure is estimated based on data from Department of Commerce, *Ibid.*, p. 54.

[15]MITI (1991), *op. cit.*, p. 216.

[16]MITI (December 1991), *op. cit.*, p. 20.

[17]See Haruo Shimada, "Japanese Management of Auto Production in the United States: An Overview of 'Humanware Technology'" in Kozo Yamamura (ed.), *Japanese Investment in the United States: Should We Be Concerned?* (Seattle, Washington: Society for Japanese Studies, 1989), pp. 199-200.

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